

UNITED STATES OF AMERICA
POSTAL RATE COMMISSION
WASHINGTON, DC 20268

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POSTAL RATE COMMISSION
OFFICE OF THE SECRETARY

Postal Rate and Fee Changes

Docket No. R97-1

PRESIDING OFFICER'S INFORMATION REQUEST NO. 3

(September 8, 1997)

The Postal Service is requested to provide the information described below to assist in developing a record for the consideration of its request for changes in rates and fees. In order to facilitate inclusion of the requested material in the evidentiary record, the Postal Service is to have a witness attest to the accuracy of the answers and be prepared to explain to the extent necessary the basis for the answers at our hearings. The answers are to be provided within 14 days.

1. In his discussion of the relation of Ramsey pricing to the Efficient Component Pricing (ECP) rule, witness Bernstein (USPS-T-31) uses Thress's own-price elasticities for single-piece letters of -0.189240 and for workshared letters of -0.289173. See page 83. Since decisions by mailers to perform more (or less) worksharing are modeled by witness Thress (USPS-T-7) with a "discount elasticity," these two own-price elasticities would seem to relate to the effects of price changes on quantities, with the level of the discount remaining constant.

The Ramsey formulas, however, contain traditional own-price elasticities defined as the change in quantity divided by the change in price, times the price-quantity ratio, other relevant variables remaining unchanged. When considering the Ramsey formulas for single-piece mail, one of the other relevant variables that remains unchanged is the price of workshared mail. Since this latter price remains unchanged, an increase in the price of single-piece mail will increase the discount by an equal amount. Accordingly, the change in quantity that enters into the numerator of the elasticity has two

components. The first is the change in quantity of single-piece mail due to the price increase itself and the second is the change in quantity due to mailers that decide to workshare. When added, these two components can provide a large numerator and therefore a large elasticity.

It appears that witness Bernstein used the lower elasticity of -0.189240 rather than the larger elasticity that would result from adding the two effects just discussed. Please explain which elasticity is relevant to Ramsey calculations and how the results would be affected by using one elasticity instead of the other. Also, please specify and explain the cross elasticities that were used to obtain the Ramsey results shown in Table 17 on page 87.

2. On page 85, witness Bernstein (USPS-T-31) notes: "A key assumption of the price calculation is that when a piece of mail shifts from single-piece to workshare, the postal marginal cost of that mail falls from the single-piece marginal cost of \$0.2324 to the workshare marginal cost of \$0.0991, thereby saving the Postal Service ... \$0.1333 per piece." Please provide any evidence available supporting the position that the savings to the Postal Service for likely-workshared mail that may become workshared is in the neighborhood of 13.33 cents per piece and, separately, supporting the position that the relevant savings is not in the neighborhood of the current 6-cent discount level (the latter figure being discussed on page 81).

3. On page 88, witness Bernstein develops an estimate of the technical losses caused by a Ramsey workshare discount of 14.38 cents when the ECP workshare discount is 13.32 cents, the latter figure being the difference in Postal Service cost between the single-piece and the workshare category. Please develop the technical losses caused by a Ramsey workshare discount for a situation where the Postal Service's savings (and the associated ECP workshare discount) are in the neighborhood of 6 cents instead of 13.32 cents.

4. In Docket No. R87-1, the Postal Service proposed to decrease the proportion of revenue obtained from the pound rate for regular Periodicals to 40 percent. This was

proposed along with evidence suggesting that the proportion should be even lower. The Commission recommended the 40 percent level and suggested that further study should be given to this question. In Docket No. R90-1, the Postal Service proposed to maintain the 40 percent level but did not provide a study. In recommending the 40 percent level, the Commission noted again the need for studying the issue further. In Dockets No. R94-1 and MC95-1, the 40 percent level was maintained and the need for further study was again noted. In this case, the Postal Service has proposed to increase the proportion to 41 percent. No study is provided. The only justification for the 41 percent level is a statement by witness Taufique that "the pound rate revenue is proposed to generate 41 percent of total revenue, compared to 40 percent in the past." (USPS-T-34 at 13.)

The Commission notes that the Revenue Forgone Reform Act requires that the advertising pound rates for Regular Periodicals be applied to Nonprofit Periodicals and Classroom Periodicals. Therefore, the level of the advertising pound rates in Regular Periodicals, which is affected by the proportion of the revenue obtained from the pound rates, takes on more importance than in the past. In order that the record may be as robust as possible on this issue, the Postal Service is asked to provide any evidence available supporting its proposal to set the proportion at 41 percent.

5. The zone distribution factors shown in column F of Workpaper RR-G, page 2, of witness Taufique do not include recognition of Science-of-Agriculture pounds. Yet the transportation costs distributed with these factors do cover Science-of-Agriculture mail. Please explain why it is appropriate to omit recognition of Science-of-Agriculture pounds from the distribution of the transportation costs.

6. Workpaper RR-G, page 3, of witness Taufique, shows the removal of 1.2 cents per pound from the advertising rates for zones 7 and 8. Consistent with the proposal to obtain 41 percent of the revenue from the pound rates, please explain where the revenue loss attendant to the 1.2 cent reduction is recovered.

7. Workpaper RR-G shows the target revenue from the pound rates on line 5 (page 1) and shows the actual revenue obtained on line 95 (page 3). Consistent with the goal of obtaining the target revenue and thereby of obtaining 41 percent of the revenue from the pound rates, please explain where account is taken of the revenue from the advertising in Science-of-Agriculture publications in Zones 1&2, SCF, and DDU.

8. Workpaper RR-J, page 1, of witness Taufique shows the subtraction of 0.1 cents per piece from the piece rate for basic non-automation Regular Periodicals, at line 31. Because all of the other piece rates are obtained by subtracting a discount from this basic nonautomation piece rate, this subtraction reduces all piece rates by 0.1 cents. Consistent with the goal of obtaining 59 percent of the revenue from the piece rates and of obtaining a target cost coverage of 107 percent, please explain where the revenue loss attendant to the 0.1 cent reduction is recovered.

9. In Docket No. R90-1, the Postal Service proposed to give the SCF discount and the DDU discount for Periodicals entirely on a per-pound basis. That proposal was based on arguments that the savings were largely pound oriented. The Commission recommended that the transportation cost savings be given on a per-pound basis and that the nontransportation cost savings be given 50 percent on a pound basis and 50 percent on a piece basis. The 50-50 split for nontransportation costs was maintained through Dockets No. R94-1 and MC95-1. In this case, the Postal Service has proposed to recognize the nontransportation costs entirely on a per-piece basis. As explained by witness Taufique (USPS-T-34 at 19): "Recognition of non-transportation drop shipment cost savings ... for the destination delivery unit (DDU) and DSCF is proposed for piece rates exclusively. This is a break from the past practice of splitting these savings between piece and pound rates." In addition to the sentence just quoted, please provide any evidence or study available to support the proposal to recognize the nontransportation costs entirely on a per-piece basis.

10. Bulk Bound Printed Matter

a. The total revenue for FY 1996, before adjustment, is shown to be \$393,163,080 both in Workpaper BPM5 of USPS-T-38 and in the Billing Determinants, page H-2. However, the same revenue is shown to be \$394,316,597 in Library Reference H-172, STBBP96A (\$394,463,133 with the included adjustment factor of 1.00037162 removed).

(1) Please explain this discrepancy, and make any necessary corrections.

(2) Using the correct revenue, please show the development of the correct adjustment factor.

b. Please explain why the total adjusted revenues in cell S75 of Library Reference H-172, STBBP96A do not reflect the revenue loss from the proposed prebarcode discount of \$3,402,961 listed in cell S72.

11. Please reconcile the parcel post volume distributions shown in the FY 1996 Billing Determinants (and used in USPS-T-37, Workpaper 1.A, pages 2 to 7) with those shown in USPS LR-H-172 STBA96A, STBR96A, and STBD96A.

	<u>FY 96 Billing Determinants</u>	<u>LR-H-172</u>
Intra-BMC	46,007,028	45,995,137
Inter-BMC	66,223,149	66,256,008
DBMC	<u>96,406,682</u>	<u>96,378,414</u>
	208,636,859	208,629,559

12. Please reconcile the revenue adjustment factors shown on USPS-T-37, Workpaper 1.D, page 7, with those shown in USPS LR-H-172, STBA96A, STBR96A, and STBD96A.

	<u>USPS-T-37</u>	<u>LR-H-172</u>
Intra-BMC	1.0197236	1.019987
Inter-BMC	0.9828643	0.982376
DBMC	1.00066296	1.000956

13. The response to POIR No. 1, question 1.a.(2) did not address the adjustment to the level of Alaskan nonpriority air attributable costs made by the Commission in dockets since R90-1. The Commission's adjustment was made so that parcel post rates for all mailers did not have to be raised to recover the high cost of intra-Alaskan air transportation. A portion of the high cost for Alaskan air transportation was deemed to be caused by a requirement of the universal service obligation, and thus an institutional cost to be borne by all mailers.

Please confirm that the level of Alaskan nonpriority air attributable costs has not been adjusted in a manner similar to that made by the Commission.

If you do not confirm, please explain where and how the adjustment is made.

14. As explained in response to POIR No. 1, question 1.b., the variability factors for the three air networks (Eagle, Western, and Christmas) as shown in Worksheet 14.0.1 reflect the removal of premium costs. The development of the Christmas network premium costs are shown in Library Reference H-85, Table 7, page 24.

Please provide the cite for the development of the other premiums or provide the costs per pound-mile, costs per pound, pound-miles, pounds, and any other data which are used in these calculations.

Please identify the witness or witnesses who will testify on these variabilities.

15. According to the response to POIR No. 1, the premium costs for the three network operations are treated as institutional costs. Please provide the rationale and analyses that demonstrate the variability of costs of the three networks.

16. Please explain why the use of incremental costs as the basis for Express Mail rates provides a reasonable contribution to institutional costs in conformance with Section 3622(b)(3) of the Act.

17. In Docket No. R90-1, the Commission recommended a new treatment for Eagle network distribution keys. In Docket No. R94-1, witness Barker stated that the Eagle network keys shown in Worksheet 14.0.7, pages 1-4, reflected the Commission's R90-1

method. The adjustments were documented in Library Reference G-115, the TRACS Eagle Estimation Programs Overview. See Docket No. R94-1, Tr. 26E/14480-82.

In MC97-2, witness Patelunas confirmed that the Service used the Commission's methodology in the development of FY 1995 Eagle Network TRACS distribution keys shown in USPS-T-5, Workpaper B, Worksheet 14.0.3.

Do the Eagle network TRACS distribution keys shown in USPS-T-5, Workpaper 14.03, reflect the Docket No. R94-1 methodology? If yes, what adjustments were made in light of the change from cubic foot-miles to pound-miles as noted by witness Nieto, USPS-T-2, page 6.

18. In USPS-T-36, Workpaper 1 and Workpaper 2, page 4, the percentage of presort nonletter pieces dropshipped to BMCs, SCFs, and DDUs is based on the percentage of presort letter pieces dropshipped to BMCs, SCFs, and DDUs, from page 2. Should the dropship distribution of nonletter pieces on page 2 be used instead to distribute the nonletter pieces to dropship category on page 4? If not, why not? If so, please show the effect on the Service's Standard (A) rate proposal.

19. To calculate test year volumes by billing determinant category, witness Moeller uses billing determinants for the first two quarters of FY 1997 for commercial mail and the first quarter of FY 1997 for nonprofit mail. See USPS-T-36, Workpaper 1, page 1 and Workpaper 2, page 1.

a. What is the rationale for using FY 1997 quarterly billing determinants rather than base year?

b. What is the rationale for using the first two quarters for commercial mail but only the first quarter for nonprofit mail?

20. Witness Moeller adds mail processing unit cost and delivery unit cost by rate category to develop cost savings for presort and automation discounts. See USPS-T-36, Workpaper 1, pages 10, 11, and 12. Witness Daniel supplies the letter mail processing unit costs (USPS-T-29) and witness Seckar supplies the flat mail processing unit costs. Witness Seckar uses two bases for computing the flat mail

processing costs: (1) actual mail makeup; and, (2) constant mail makeup. The actual mail makeup approach reflects cost differences resulting from worksharing and inherent mail characteristics. The constant mail makeup approach primarily reflects cost savings resulting from mailer-applied barcodes. See USPS-T-26, page 4. Witness Daniel, however, does not use a constant mail makeup approach for letter mail processing unit cost. Witness Moeller uses witness Seckar's constant mail makeup costs as the basis for worksharing discounts for flats. See USPS-T-36, page 19.

Please explain why the discounts for letters do not reflect the same constant mail makeup basis used for flats. Please calculate the cost savings for letters using a constant makeup approach.

21. For the purpose of proposing a residual shape surcharge, witness Moeller relies on witness Crum's unit costs by shape. See USPS-T-36 at 13. Witness Crum uses the shape costs presented in LR H-108, Table 3 (which reflect total costs, not just mail processing and delivery), and calculates the unit cost difference between flats and parcels (including IPPs) by adjusting to remove the differences resulting from variation in presort and dropshipping.

a. Is this characterization correct?

b. Please provide the rationale for using mail processing and delivery costs for computing worksharing cost differences and shape cost differences between letters and flats but using total costs for computing shape cost differences between flats and Parcels (including IPPs).

22. In USPS-T-32, page 41, witness Fronk states that the auditing approach for Prepaid Reply Mail (PRM) will be "modeled after those currently in use for outbound manifests." Please describe these manifest procedures in detail.

23. In USPS-T-32, page 41, witness Fronk states: "The Postal Service estimates that to establish a PRM 'system' would involve 14 person days during the first year. Once established, the Postal Service anticipates that 10 person days would be involved annually at a labor cost of about \$4,100."

- a. Please define what constitutes a "system."
 - b. Is a separate "system" necessary for each customer?
 - c. Once the "system" is established, it appears that the labor costs incurred by the Postal Service are estimated to be \$4,100 annually. Why is it necessary for the Service to continue charging a \$1,000 monthly fee?
 - d. Did the Postal Service consider charging a one time "set-up" fee and lower monthly fees? If yes, why was this idea rejected?
 - e. If the fee structure discussed in d. was not considered, please discuss advantages and disadvantages of such a structure compared to the Service's proposal.
 - f. Footnote 15 on page 41 states that the annual labor costs include two person days for "ongoing administrative activities." Please describe these ongoing activities.
24. In USPS-T-32, page 43, witness Fronk lists credit card companies and utilities as industries likely to be interested in PRM. How was it determined that these industries would be "attracted to this rate?"
25. In estimating volume for PRM, witness Fronk uses a percentage (2%) based on "the experience of the Postal Service in introducing a barcode discount in the late 1980s." Please explain the similarities between the introduction of PRM and the introduction of barcodes.
26. In USPS-T-25, Appendix II, pages 4-5, the footnotes cite LR H-185 as the source of the figures in columns 1-5. Please provide specific page, or table, citations in LR H-185 where the figures in USPS-T-25, Appendix II, page 4, can be found. Please explain why the sum of individual row totals on pages 4 and 5 do not equal the totals given in LR H-185, Table 7.
27. In Library Reference H-179, Table 12, reasons for not using BRMAS software are given. According to this table, 49.9 percent of sites report that there is "not enough volume to justify use," 7.8 percent of sites report that there are "problems with BRMAS

software not solvable on the local level,” and 6.3 percent give “other” as the reason for not using BRMAS software.

a. Please describe all problems with BRMAS software that have been identified. Please discuss the reasons these problems are “not solvable on the local level.”

b. Though only 6.3 percent of sites gave “other” as a response, this 6.3 percent constitutes 33.7 percent of BRM volume. Please describe what “other” reasons there may be for not using BRMAS software.

28. In past cases, IOCS data were used to separate accrued Clerks and Mailhandler costs (Segment 3) into mail processing, window service and administrative cost components. In R97-1, the service uses MODS data to separate the accrued Segment 3 costs into these three cost components for MODS 1 and 2 offices. The following table shows the results from using the two different systems to separate the costs and shows that approximately \$792 million of window service and administrative costs migrate to the mail processing category as a result of using MODS.

Accrued Costs (Millions)

	<u>Mail Processing</u>	<u>Window Service</u>	<u>Administrative</u>	<u>Total</u>
Using MODS ¹	13,247	1,907	1,302	16,456
Using IOCS ²	12,455	2,013	1,987	16,456
Difference	792	(107)	(685)	0

¹ USPS T-5 Exhibit 5C page 9.

² LR H-1 page 3-2.

Please elaborate on the discussion in USPS-T-12, pages 6 and 7, regarding the reasons for the migration. In particular, please identify the approximate percentage of the cost changes due to: (1) an IOCS data collector observing an employee working at a different task from the MODS activity code the employee is clocked into at the time of the observation; (2) window service and administrative activities being redefined as mail processing, or vice-a-versa, as indicated in the USPS response to interrogatory

OCA/USPS-T12-27, lines 3-5; or (3) any other reason. Please provide a listing of the IOCS activity codes being redefined due to the second case and show the amount of costs moving due to changes in definitions.

29. Please discuss the instances in which local facility managers can customize the MODS codes to their own management needs and the distortion that this has on the aggregation of data for national purposes. In particular, what is the extent of the customization, does the customization isolate hours and pieces handled data into pools that are not captured in the 46 cost pools created by witness Degen, and how is this effect accounted for by witnesses Degen and Bradley in their analyses?

30. Please provide additional descriptive information on the "fundamental restructuring of Postal Service operations in FY 1993" that led to the use of the segmented time trend in witness Bradley's econometric analysis of mail processing. In particular, describe the specific changes that constituted the "potentially material restructuring of mail processing at that time" referred to in the response to DMA/USPS-T14-24 and the "reorganization of the workroom floor that occurred in FY 1993" referred to in the response to UPS/USPS-T14-19. Also, discuss how these changes impacted the time trend so significantly.

31. Please confirm that some processing facilities locate portions of their automation work, in particular Delivery Point Sorting on Bar Code Sorting machines, in delivery units; and that the manhours and pieces processed there are not captured by the MODS system. If confirmed, how do witnesses Degen and Bradley account for this in their analyses?

32. In LR H-146, the reference for the Administrative costs of \$683,327 million in Table I-1, Part 1 of 2, page I-4, is the report "Administrative and Window Service Cost Pool Dollars - FY96 MODS 1&2." The referenced report is given on page 28 and is generated by the SAS code for MODSPOOL at pages 6 and 7. In the report and in the SAS code, the LDC entry is blank. Please identify the type of activities included in the

administrative pool by providing the LDC, MODS codes, IOCS codes or a description of the activities in the pool.

33. The printout of member name VBL2 (the mail volume cost effect) in USPS Library Reference H-4 at 531 lists the equipment distribution key OCR, component no. 963, three different times in two component lists under control string "06." Also, the square foot and rental value OCR distribution key, component no. 913, receives no mail volume cost adjustment, unlike the other square foot, rental value, and equipment distribution keys.

Please explain why the component no. 963 is listed as receiving a mail volume cost effect three times in VBL2 and also please explain why the component no. 913 does not receive a mail volume cost adjustment.

34. USPS-T-15, Appendix A, describes the Cost Reductions and Other Programs and the distribution of cost savings from each of these programs for FY 1997, the Test Year Before Rates and the Test Year After Rates. The appendix, pages 6, 11, and 16, list the various Cost Reduction programs and Other Programs, and their distribution keys. These tables show three Remote Barcode System (RBCS) programs and their distribution keys. The Other Programs cost changes are distributed on the basis of the equipment distribution key "RBCS," component no. 924. However, the Cost Reductions affects related to these programs are distributed using equipment distribution key "LSM," component no. 916. It should be noted that in Docket No. MC96-3, the FY 1996 Cost Reductions effects for the RBCS programs were distributed using the equipment distribution key "RBCS," component no. 924.

Please explain why the equipment distribution key "LSM," component no. 916 was used to distribute the RBCS cost reductions in the roll-forward. If the use of component no. 916 to distribute the RBCS cost reductions programs is an error, please provide the correct distribution key component and the effect on costs for FY 1997, the Test Year Before Rates and the Test Year After Rates.

35. USPS-T-15, page 9, describes the treatment of indirect costs in the cost roll-forward process. Witness Patelunas notes that "For each of these indirect costs, the direct cost or factor with which it varies is identified and treated in the **same manner as in the Base Year 1996** cost presentation. The cost roll-forward indirect cost distributions are generally described in USPS Library Reference H-4 in member names VBL2 (Mail Volume cost effect), VBL3 (Non-volume Workload Effect), and VBL4 (Additional Workday effect), under control string "21."

There appear to be indirect costs in Cost Segment 12 which do not follow this general description. These are components 545, Personnel-vehicle service drivers, 550, supplies & materials-vehicle service drivers, and 568, vehicle hire, vehicle service drivers, which are identified and treated in the same manner as component 57, Vehicle Service Drivers in the base year. However, these components are not treated the same in the roll-forward process. An examination of member name VBL2 in USPS LR-4, page 534, shows the control string 21 and component 57, vehicle service drivers only affecting the component 675, supervision of vehicle service drivers and not the segment 12 components described above. The same situation applies to the segment 12 components identified as being indirectly variable to segment 10 rural carrier personnel.

Please explain why the indirect components noted above were left out of the roll-forward process. If these components were supposed to be included please show the effect on costs for FY 1997, the Test Year Before Rates and the Test Year After Rates.



Edward J. Gleiman
Presiding Officer